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IN THE

Supreme Court of The United States

No. 552.

INTERSTATE TRANSIT LINES,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
To The United States Circuit Court of Appeals
For the Eighth Circuit.

BRIEF OF PETITIONER IN REPLY TO RESPONDENT'S BRIEF IN OPPOSITION.

JOSEPH F. MANN,
DARWIN P. KINGSLEY, JR.,
120 Broadway,
New York City.

NELSON TROTTMAN,
400 W. Madison Street,
Chicago, Illinois.
Attorneys for Petitioner.

MC CORMICK AND HENDERSON, INC., CHICAGO

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Respondent asserts (Brief p. 5) that this case turns on its own facts and presents no conflict. This assertion ignores the announced views of the court below, both in the present case and in its recent decision in *Palcar Real Estate Company* v. *Commissioner*, decided November 3, 1942, not yet reported but available in the Commerce Clearing House Federal Tax Service at paragraph 9733, on page

10,728. The Eighth Circuit Court of Appeals has in these cases held that a corporate taxpayer may never, to reduce its tax liability, invoke the doctrine that a subsidiary is but its agent or *alter ego*. The Fifth Circuit Court of Appeals, in the *Moline Properties, Inc.* case, decided November 7, 1942, not yet reported but available in the Commerce Clearing House Service at paragraph 9728 on page 10,717, reached the same conclusion (reversing the Board's decision reported at 45 B.T.A. 647). The Second Circuit Court of Appeals made a like holding in *Watson* v. *Commissioner*, 124 Fed. (2d) 437. All four cases are bottomed on this Court's dictum in *Higgins* v. *Smith*, 308 U. S. 473, 60 S. Ct. 355, 84 L. Ed. 406; but the Fourth Circuit Court of Appeals in the *Brager* case, 124 Fed. (2d) 349, did not so regard the effect of *Higgins* v. *Smith*, and held the exact opposite. Also, the Tenth Circuit Court of Appeals in the *Inland Development Company* case, 120 Fed. (2d) 986, reached the contrary conclusion and cited *Higgins* v. *Smith* in support of the application of the "agency" doctrine in favor of the taxpayer. Thus, even if earlier decisions prior to *Higgins* v. *Smith* supporting the present taxpayer are disregarded, there are now six Circuit Court of Appeals decisions, including the present case, by five Circuit Courts of Appeals, which have been handed down since the decision in *Higgins* v. *Smith*. In four of them, decided by the Second, Fifth and Eighth Circuits, taxpayers have been told that they may never invoke the "agency" doctrine, and that the doctrine, under which the corporate entities are disregarded, is available in tax cases only to the government. (In the present case the Court below assumed that the subsidiary was in fact an agent of the taxpayer, a necessary assumption in view of the government's admission in the pleadings. Rec. p. 15, par. V, 2.) In the Fourth and Tenth Circuits the contrary is the rule, and in them the taxpayer may, if the facts warrant it, invoke the doc-

trine. The present application does not, therefore, as respondent asserts, involve merely fact questions.[1] The Court below, in its opinion, assumed that the subsidiary was the taxpayer's agent (Rec. p. 92). The unsettled question of law remains whether, assuming such agency to exist, the benefit of the agency doctrine can ever avail the taxpayer when it is the taxpayer, not the government, that invokes the doctrine. On this point the cases are in irreconcilable conflict.

Respondent himself mentions (Brief pp. 8, 9) three of the cases, the *Brager*, *Watson* and *Moline Properties, Inc.* decisions, although he ignores the hopeless conflict between the *Brager* and the other two cases, and, instead, suggests a shadowy distinction from the former, and cites the two latter cases in support of his argument. A comparison of the Board's findings and opinion in the *Moline Properties, Inc.* case, 45 B.T.A. 647, with the Fifth Circuit opinion reversing the Board emphasizes the length to which that and the Second and Eighth Circuit Courts of Appeals appear to have gone in assumed obedience to the *Higgins* v. *Smith* dictum. That the question presented is one of law, not of fact, is emphasized by the Fifth Circuit's refusal to accept the Board's conclusion, based on facts, to the effect that the case fell within the Board's holdings wherein it had "disregarded the corporate entity to effect a more realistic assessment of taxes." 45 B.T.A. 647. The Commissioner's

[1] In furtherance of this assertion, respondent has referred (Brief p. 4) to the mechanics of the accounting. In the petition herein it was pointed out (on page 2) that this subject was not relevant to the present application. It played no part in the decision below, for aught that appears in the court's opinion. Suffice it to say that during 1936 the present taxpayer in fact "paid or incurred" the expenses producing the deficit, and therefore "paid or incurred" the deficit.

brief on file in the Fifth Circuit in the *Moline Properties, Inc.* case (number 10,279 on the Fifth Circuit's docket) treats the question as one entirely of law, builds the argument for reversal entirely on *Higgins* v. *Smith*, and grudgingly recognizes an inconsistency with the *Inland Development Company* and *Brager* cases, in the latter of which he admits that the court "rejected the generality of the principle laid down in *Higgins* v. *Smith*" that the taxpayer employing a corporation "may not disavow it but must accept such tax disadvantages as may result." The Commissioner then, in his brief, admitted that this Court's statement in *Higgins* v. *Smith* "was perhaps beyond the necessities of the immediate issue in the case," but argues that it was deliberate as a warning "against an interpretation of the holding that would lead taxpayers to urge the case as authority in situations where it would be to their advantage to urge non-recognition of their chosen forms of doing business." Yet the Tenth Circuit Court of Appeals in the *Inland Development Company* case did so interpret the holding in support of its decision in favor of the taxpayer.

The fact is that the law on this subject is now in a hopeless muddle that cannot be resolved unless by a decision of this Court holding either, with the Second, Fifth and Eighth Circuits, that the doctrine may never be invoked by a taxpayer, or, with the Fourth and Tenth Circuits, that a taxpayer may invoke it where the facts warrant and that each case depends on its own facts.

Respondent's "Statement" and factual references in his argument convey the impression that the deduction here claimed arose from intra-state business which, respondent says (Brief p. 5), taxpayer "lacked legal ca-

pacity" to perform,[1] wherefore, says respondent (Brief pp. 5, 6), the deficit was not incurred in taxpayer's business. Thus does respondent, seeking to have this case treated as one merely turning "upon its own facts" (Brief p. 5), brush lightly over his own express admission in his pleading that taxpayer was in 1936 engaged in inter-state transportation of passengers between Chicago and Los Angeles (Rec. p. 15); and also avoid the lower Court's own assumption that the subsidiary was an agent of the petitioner as a carrier of its inter-state traffic in California (Rec. p. 92). The opinion below concedes, *arguendo*, the fact of agency, but treats this fact as of no consequence. Yet it was because of the subsidiary's agency for it in the conduct of its business as an inter-state carrier of passengers that the taxpayer bore the subsidiary's deficit.

On the question whether a corporation which in the course of its business assumes another's deficit, pursuant to contract, may deduct the amount thereof as a business expense, respondent's attempted distinction of the *New York, Chicago and St. Louis* case, 71 Fed. (2d) 956 (App. D. C.) (Brief p. 6), and the *Wiggin* case, 46 Fed. (2) 743, (C.C.A. 1) (Brief pp. 5, 6), is not in accordance with the express recognition by the Court below (Rec. p. 94 and footnote) that there was not a "unanimity of decision," and that these two cases at least are not in accordance with the present decision. Of the *Wiggin* case respondent says (Brief p. 6) that the Court there "construed the contract to attribute the losses to the contracting individual and accordingly allowed him the corresponding deduction." Just why that language is not equally applicable here is not apparent. In that case the contract,

[1] This statement is incorrect as applied to 1936. This subject is explained fully on pages 3 and 4, and in the footnote, of the petition herein.

made between a corporation and its main stockholder, provided for the latter's employment by the former with the understanding that his compensation should be the corporation's net profits for two years, and that he should pay all losses incurred by the corporation for the same period, and that in case of loss he had the option to extend the period of the agreement. Under this agreement he paid large losses of the corporation from 1922 to 1925, inclusive, which he claimed as business expense deductions for those years. Upon the express ground that the corporation's business "was not the business of the taxpayer" the Board of Tax Appeals refused to sanction these deductions (19 B.T.A. 282). The First Circuit reversed, holding that the corporation's losses were the taxpayer's losses, "practically and legally, as much as if he had taken over the business and run it in his own name." The Court also said that the losses were deductible as "incurred in any transaction entered into for profit," which, notwithstanding respondent's intimation (Brief p. 6) that this suggested alternative ground for decision also distinguishes the case, would also support the claimed deduction in the present case. It is simply impossible to reconcile the *Wiggin* case with the decision below, and the Court below apparently recognizes that this is the case (Rec. p. 94 and footnote). The point involved in both cases has never been decided by this Court. The only two cases decided by this Court which respondent cites on this point (Brief p. 5), *New Colonial Ice Company* v. *Helvering*, 292 U. S. 435, 54 S. Ct. 788, 78 L. Ed. 1348, and *Deputy* v. *DuPont*, 308 U. S. 488, 60 S. Ct. 363, 84 L. Ed. 416, do not decide the legal question here involved. The *New Colonial Ice Company* case is no wise in point. The *Deputy* case involved a single extraordinary and unusual transaction of considerable magnitude of an individual stockholder of a large corporation who owned only sixteen

per cent of its stock, and the transaction, although undertaken by him, was to assist the corporation in its business relations with its officers; whereas here the expenses which produced the deficit were incurred in the ordinary, regular course of the taxpayer's own inter-state business, conducted through its agent, the subsidiary. The legal question whether under such circumstances the payment pursuant to contract of the deficit of the agent is a business expense or a capital payment is one on which the Circuit Courts of Appeals are not in agreement, as the Court below itself points out (Rec. p. 94 and footnote). The First Circuit in the *Wiggins* case has decided this question contrary to the decision below. Some other decisions collected by the Court below (Rec. p. 94 and footnote) are also contrary.

Dated at Chicago, Illinois, December 23, 1942.

Respectfully submitted,

JOSEPH F. MANN,
DARWIN P. KINGSLEY, JR.,
120 Broadway,
New York City, New York.

NELSON TROTTMAN,
400 West Madison Street,
Chicago, Illinois.
Attorneys for Petitioner.